Clerk, Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1956

No. 306

THE COLONY, INC., Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BERNARD H. BARNETT,
RICHARD C. OLDHAM,
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WESTERFIELD-BONTE CO., INCORPORATED, LOUISVILLE, KY.

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Text of Statutes Involved.

INTERNAL REVENUE CODE OF 1939:

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

Except as provided in section 276—

(a) General Rule—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(c) Omission from Gross Income—If the taxpayer omits from gross income the amounts properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

SEC. 276. SAME—EXCEPTIONS

(b) Waiver—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

INTERNAL REVENUE CODE OF 1954:

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(e) Omission from Gross Income—

Except as otherwise provided in subsection (c)—

(1) INCOME TAXES.—In the case of any tax imposed by subtitle A—

LIST OF AUTHORITIES.

Cases: PAGE

Davis v. Hightower, 230 F. 2d 549 6

Deakman-Wells Co. v. Commissioner, 213 F. 2d 894 6

John E. Goodenow v. Commissioner, 238 F. 2d 20 6

Slaff v. Commissioner, 220 F. 2d 65 6

Uptegrove Lumber Co. v. Commissioner, 204 F. 2d 570 6

Statutes:

Section 275 (a) of the Internal Revenue Code of 1939, 26 U. S. C. § 275 (a) 4

Section 275 (c) of the Internal Revenue Code of 1939, 26 U. S. C. § 275 (c) 2–3

Section 276 (b) of the Internal Revenue Code of 1939, 26 U. S. C. § 276 (b) 4

Section 6501 (e) of the Internal Revenue Code of 1954, 26 U. S. C. § 6501 (e) 10

Section 7851 (d) of the Internal Revenue Code of 1954, 26 U. S. C. § 7851 (d) 10

Miscellaneous:

Revised Rules, Supreme Court of the United States, Rule 19 (1) (b) 6

Vincent, C. J., Address Before American Bar Association, September 7, 1949 6

Reis v. Commissioner, 142 F. 2d 900 6

(A) GENERAL RULE—If the taxpayer omits from gross income an amount property includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

SEC. 7851. APPLICABILITY OF REVENUE LAWS.

(d) Periods of Limitation—

All periods of limitation, whether applicable to civil causes and proceedings, or to the prosecution of offenses, or for the recovery of penalties or forfeitures, hereby repealed shall not be affected thereby, but all suits, proceedings, or prosecutions, whether civil or criminal, for causes arising, or acts done or committed, prior to said repeal, may be commenced and prosecuted within the same time as if this title had not been enacted.

IN THE

Supreme Court of the United States

October Term, 1957.

No. _____.

THE COLONY, INC., - - - - - - *Petitioner,*

v.

THE COMMISSIONER OF INTERNAL REVENUE, - - - - - - - *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Petitioner prays that a writ of certiorari issue to review the judgment herein of the United States Court of Appeals for the Sixth Circuit.

OPINIONS BELOW.

The opinion and judgment of the Court of Appeals is printed in the Appendix hereto (App. 13-16). It is reported in 244 F. 2d 75. The opinion of the Tax Court of the United States is printed in the Appendix hereto (App. 17). It is reported in 26 T. C. No. 3.

OPINIONS AND JUDGMENTS BELOW.

UNITED STATES COURT OF APPEALS
For the Sixth Circuit
No. 13,008

The Colony, Inc., - - - - - - Petitioner,

v.

Commissioner of Internal Revenue, - - - Respondent.

Appeal from the Tax Court of the United States

April 22, 1957

Richard C. Oldham and Baldwin C. Barnam, Louisville, Kentucky, for petitioner.

Charles K. Rice, John Potts Barnes, Lee A. Jackson, Robert N. Anderson, Grant M. Wiprud, John M. Morawski, and Marvin W. Weinstein, Washington, D. C. for respondent.

Before McAllister, Miller and Stewart, Circuit Judges. Per Curiam.

The sole question on this review is whether the five year statute of limitations contained in section 275(c) of the Internal Revenue Code of 1939 was applicable in this case, as the Tax Court held.[1]

[1] "(c) Omission from gross income. If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed."

JURISDICTION.

The judgment of the Court of Appeals was entered on April 22, 1957 (App. 15-16). No petition for rehearing was filed. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED.

Is the 5-year statute of limitations under Section 275 (c), of the Internal Revenue Code of 1939, 26 U.S.C. Section 275 (c), applicable where the petitioner fully reported on its income tax returns all of its gross receipts from the sale of land and improvements, but where the Commissioner of Internal Revenue disallowed certain improvement costs, thereby reducing petitioner's cost basis of the land and improvements, which disallowance resulted in an increase in petitioner's gross profit in an amount in excess of 25% of the gross profit reported?

STATUTES INVOLVED.

The full text of Section 275 (c) of the Internal Revenue Code of 1939, 26 U.S.C. Section 275 (c), is as follows:

> "SEC. 275—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.
>
> * * * * * * *
>
> (c) Omission from Gross Income.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25%

That petitioner is a corporation dealing in real estate. Its income tax returns for the years in question contained understatements of gross income of more than twenty-five percent resulting from an erroneous overstatement of the basis of land sold, rather than from any omission of gross receipts. Under these circumstances it is the petitioner's contention that the general three-year limitation period of section 275 (a) of the 1939 Code is applicable. As petitioner's counsel correctly points out, the decisions of the Courts of Appeals of several other circuits give clear support to this view. *Uptegrove Lumber Co.* v. *Commissioner*, 204 F. 2d 570 (3 Cir., 1953); *Deakman-Wells Co.* v. *Commissioner*, 213 F. 2d 894 (3 Cir., 1954); *Goodenow* v. *Commissioner*, 238 F. 2d 20 (8 Cir., 1956); cf. *Slaff* v. *Commissioner*, 220 F. 2d 65 (9 Cir., 1955); *Davis* v. *Hightower*, 230 F. 2d 549 (5 Cir., 1956).

The reasoning of these cases is not without considerable persuasive force, and if the question were here for the first time, we might be disposed to follow them. However, the question has already been decided by this court in *Reis* v. *Commissioner*, 142 F. 2d 900 (6 Cir., 1944), where it was held that the five-year limitation was applicable when the taxpayer's understatement of gross income of more than twenty-five percent was the result of his overstatement of the cost basis of property sold. The facts in the *Reis* case are, of course, not identical with the facts in the present case, but the issue presented is the same.

Upon the authority of *Reis* v. *Commissioner* the decision of the Tax Court is affirmed.

of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within five years after the return was filed."

STATEMENT.

Petitioner is a corporation organized and existing under the laws of the Commonwealth of Kentucky with principal office and place of business at Fayette County, Kentucky. Its principal business consists of the development and sale of lots in a subdivision called "The Colony." In 1945 it acquired unimproved land for this purpose and commenced the development thereof, which included, among other things, the construction of a water supply system at a cost of approximately $33,000. Lots from said land were sold in each of the petitioner's taxable years ended October 31, 1946, October 31, 1947, and October 31, 1950.

All gross receipts from the sale of such lots were fully reported in petitioner's federal income tax returns for each of said years. In arriving at its gross profit from these sales, petitioner used a cost basis for the lots sold which included certain items of development expense, including a portion of the cost of the construction of the water supply system. Upon subsequent examination of petitioner's income tax returns, the Commissioner of Internal Revenue determined that certain of the development expenses, including the cost of constructing the water supply system, were not properly includible in the cost basis of the land sold.

OPINION OF THE TAX COURT.

THE COLONY, INC., PETITIONER, *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket No. 53681. Filed April 9, 1956.

1. The petitioner is a corporation organized to acquire, subdivide, and sell real estate. It was organized with a total capital of $1,000. It obtained bank loans, secured by liens on its real estate, in an amount in excess of $149,000. Five of petitioner's stockholders paid over a total of $57,800 to petitioner and received petitioner's interest bearing promissory notes in that amount. *Held*, the $57,800 paid over to petitioner by its stockholders constituted contributions to capital, rather than bona fide loans, and amounts paid by petitioner to the stockholders in 1948, 1949, and 1950 constituted nondeductible distributions in the nature of dividends rather than interest on indebtedness which is deductible under section 23 (b) of the 1939 Code.

2. In determining its basis for gain or loss in the subdivision lots which it sold in 1946, 1947, and 1950, the petitioner added to its cost of the lots a pro rata portion of improvement expenses which it incurred or estimated that it would incur in developing the subdivision. *Held*, the cost of a water supply system which petitioner continued to own and operate during the taxable years did not constitute a development expense which could be added to petitioner's basis in the subdivision lots; *held, further*, petitioner's basis in the subdivision lots includes the amount of payments made by petitioner to two utility companies to induce the latter to extend their services to petitioner's subdivision; *held, further*, the respondent's determination that petitioner overestimated

its development expenses in the amount of $5,590.32 is sustained.

3. For the taxable years ended October 31, 1946, and October 31, 1947, the petitioner omitted from gross income an amount properly includible therein which was in excess of 25 per cent of the gross income stated in its returns. The understatements of gross income resulted from overstatements of cost of goods sold, rather than from omissions of gross receipts. *Held*, the 5-year statute of limitations contained in section 275 (c) of the 1939 Code is applicable, and the deficiencies determined for the years ended October 31, 1946, and October 31, 1947, are not barred. *Estate of J. W. Gibbs, Sr.*, 21 T. C. 443, followed.

Andrew W. Duncan, Esq., and *Don S. Sturgill, Esq.*, for the petitioner.

James F. Shea, Esq., for the respondent.

The Commissioner determined deficiencies in income tax and excess profits tax as follows:

Year ended October 31	Income tax	Excess profits tax
1946	$7,988.72	$2,356.71
1947	1,194.29	.....
1948	987.31	.....
1950	224.23	.....

The year ended October 31, 1949, also is involved because the amount of net operating loss sustained in that year will determine the amount of net operatnig loss deduction allowable for the year ended October 31, 1947. The issues to be decided are: (1) Whether payments made by petitioner to its shareholders in the amounts of $8,988.41, $3,468, and $3,468, in the taxable years ended October 31, 1948, 1949, and 1950, respectively, were deductible by petitioner as interest payments, or whether such payments were nondeductible distributions in the nature of divi-

The Commissioner's aforesaid determination of deficiencies was mailed to the petitioner within an extended period provided in waivers which petitioner executed more than three years but less than five years after the returns for the taxable years ended October 31, 1946, and October 31, 1947 were filed.[1] Petitioner duly and timely filed its petition to the Tax Court of the United States protesting the deficiency determination on the ground, *inter alia,* that the expiration of the general three year period of limitations provided for in Section 275 (a) of the Internal Revenue Code of 1939 (App. 13-14) barred the assessment of the alleged deficiencies in taxes.

PROCEEDINGS IN THE TAX COURT.

The Tax Court substantially sustained the Commissioner on the merits as to the disallowance of a portion of the cost basis claimed in respect of the lots sold during the taxable years ended October 31, 1946 and October 31, 1947 (see Issue 2, Tax Court Opinion, App. 38-45). Furthermore, the Tax Court held that the 5-year statute of limitations contained in Section 275 (c) of the Internal Revenue Code of 1939 was applicable, and that the assessment of the deficiencies determined for said years was not barred.

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[1] A waiver, to be valid, must be executed prior to the expiration of the period of limitations. See Section 276(b) of the Internal Revenue Code of 1939, 26 U. S. C. 276(b) (App. 13). Accordingly, the execution of the waiver in this case did not serve to extend the general three-year statute of limitations provided for in Section 275(a) of the Internal Revenue Code of 1939, 26 U. S. C. 275(a).

dends; (2) whether petitioner's cost of subdivision lots includes the expenditures made to construct a water supply for the subdivision and the payments made to public utilities in order to induce the utilities to extend their service to the subdivision; and (3) whether the deficiencies determined for the years ended October 31, 1946, and October 31, 1947, are barred by the statute of limitations.

FINDINGS OF FACT.

The petitioner is a corporation organized under the laws of the State of Kentucky. Petitioner kept its books and filed its returns on an accrual method for fiscal years ended October 31. Petitioner's returns for the taxable years were filed with the collector of internal revenue for the district of Kentucky.

The petitioner's principal business is the development and sale of lots in a subdivision called "The Colony," which is located outside the city limits of Lexington, Kentucky. The petitioner also owned a water supply and distribution system, and beginning in 1949, sold water to houses which were built in the subdivision.

Issue 1. Deduction of Payments to Stockholders.

The petitioner was incorporated on or about November 14, 1945. Its authorized capital stock, which was all issued, consisted of 400 shares of capital stock without par value. Its paid-in capital was $1,000, or $2.50 per share of capital stock.

On or about April 19, 1946, Hugh Meriwether, L. J. Blakely, and Charles Sturgill, as owners of all of the petitioner's stock, entered into an agreement with Dr. Halbert Leet. The agreement recited that Dr. Leet agreed to lend petitioner, on petitioner's note, the sum of $17,500 for 5 years with interest at 6 per cent, payable semiannually; that Meriwether, Blakely, and Sturgill agreed that

PROCEEDINGS IN THE COURT OF APPEALS.

Petitioner duly and timely appealed to the Court of Appeals for the Sixth Circuit on the sole question of whether the 5-year statute of limitations contained in Section 275 (c) of the Internal Revenue Code of 1939 was applicable in respect of the deficiencies determined for the taxable years ended October 31, 1946 and October 31, 1947.

The Court of Appeals affirmed the Tax Court on question, stating in part as follows:

> ". . . it is the petitioner's contention that the general three-year limitation period of section 275 (a) of the 1939 Code is applicable. As petitioner's counsel correctly points out, the decisions of the Courts of Appeals of several other circuits give clear support to this view. *Uptegrove Lumber Co.* v. *Commissioner,* 204 F. 2d 570 (3 Cir., 1953); *Deakman-Wells Co.* v. *Commissioner,* 213 F. 2d 894 (3 Cir., 1954); *Goodenow* v. *Commissioner,* 238 F. 2d 20 (8 Cir., 1956); cf *Slaff* v. *Commissioner,* 220 F. 2d 65 (9 Cir., 1955); *Davis* v. *Hightower,* 230 F. 2d 549 (5 Cir., 1956).
>
> "The reasoning of these cases is not without considerable persuasive force, and if the question were here for the first time, we might be disposed to follow them. However, the question has already been decided by this court in *Reis* v. *Commissioner,* 142 F. 2d 900 (6 Cir., 1944), where it was held that the five-year limitation was applicable when the taxpayer's understatement of gross income of more than twenty-five per cent was the result of his overstatement of the cost basis of property sold. The facts in the *Reis* case are, of

they would convey to Dr. Leet, without further consideration, 10 per cent of petitioner's stock, that is, 40 shares; and that no dividends would be paid by petitioner without Dr. Leet's consent until the note was paid. The agreement between Dr. Leet and petitioner's shareholders provides, in part, as follows:

> This memorandum of agreement between Hugh Meriwether, L. J. Blakely and Charles Sturgill, of Lexington, Ky., owners of the capital stock of the Kentucky corporation The Colony, parties of the first part, hereinafter called the "Stockholders," and Dr. Halbert Leet, of Lexington, Ky., party of the second part, hereinafter called "Dr. Leet," witnesseth that it is agreed by and between the parties hereto as follows:
>
> Dr. Leet shall lend to the said corporation, The Colony on or before the 25th day of April, 1946, the sum of Seventeen Thousand Five Hundred Dollars ($17,500.00) upon the latter's negotiable promissory note in the said sum of money to be dated the day said loan is made, and to be payable on or before five years after date, with interest thereon at the rate of 6% per annum, payable semi-annually, from its date until its payment.
>
> The Stockholders shall, at the same time with the making of said loan, cause the said corporation to execute and deliver said note to Dr. Leet, and will assign and transfer to Dr. Leet as his own—without further consideration—ten per cent (10%) of the capital stock of said corporation; and they, and their successors, if any, in the ownership of their respective shares of stock of said corporation, shall see to it that no dividend is paid by said corporation, (except with the consent of Dr. Leet or his successors in ownership of said 10% of the stock) until said note (and any similar note issue or to be issued by the corporation under similar circumstances) shall have been paid.

On April 24, 1946, Dr. Leet paid $17,500 to petitioner in exchange for its note, and received 40 shares of petitioner's stock from Meriwether, Blakely, and Sturgill. On the same day, L. B. Shouse also paid $17,500 to petitioner

course, not identical with the facts in the present case, but the issue presented is the same.

"Upon the authority of *Reis* v. *Commissioner* the decision of the Tax Court is affirmed."

REASONS FOR GRANTING THE WRIT.

The Decision Below Is in Direct and Irreconcilable Conflict With the Decisions of the Courts of Appeal for the Third Circuit, Eighth Circuit, Ninth Circuit, and Fifth Circuit.

The decision of the Court below on the interpretation to be given to Section 275 (c) of the internal Revenue Code of 1939 can not possibly be reconciled with the decisions of the Third Circuit in *Uptegrove Lumber Co.* v. *Commissioner,* 204 F. 2d 570 (1953), and *Deakman-Wells Co., Inc.* v. *Commissioner,* 213 F. 2d 894 (1954); and the decision of the Eighth Circuit in *John E. Goodenow* v. *Commissioner,* 238 F. 2d 20 (1956). Although arising on different facts, the Sixth Circuit's decision in this case is in irreconcilable conflict with the interpretation of Section 275 (c) of the 1939 Code adopted by the Ninth Circuit in *Slaff* v. *Commissioner,* 220 F. 2d 65 (1955), and the Fifth Circuit in *Davis* v. *Hightower,* 230 F. 2d 549 (1956).

The conflict on this important question of federal law is direct. It is precisely the type of conflict which this Court recognizes under its Rule 19(1) (b) pursuant to its purpose "to secure the national rights and uniformity of Judgmts".[2]

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[2] Address of the late Chief Justice Vinson before the American Bar Association, September 7, 1949, quoting from Statement of John Rutledge of South Carolina during debates before the Constitutional Convention.

in exchange for its note, and received 40 shares of petitioner's stock from Meriwether, Blakely, and Sturgill. Also, on the same day, Meriwether, Blakely, and Sturgill each paid $7,600 to petitioner in exchange for similar promissory notes. The total amount received by petitioner on April 24, 1946, from the five individuals in exchange for its notes was $57,800. The notes issued by petitioner stated that repayment was to be made in 5 years, that is, on April 24, 1951, and that interest was payable at the rate of 6 per cent.

Prior to the end of petitioner's first fiscal year, on October 31, 1946, petitioner also issued notes in the amount of $149,403 to banks. The notes held by the banks were secured by liens on petitioner's real estate.

Also, prior to October 31, 1946, Gilmore N. Nunn acquired 4 shares of petitioner's stock from Meriwether, Blakely, and Sturgill. On October 31, 1946, petitioner's stock and notes payable were held as follows:

Name	Shares of petitioner's stock	Investment in stock at $2.50 per share	Face amount of petitioner's notes
Hugh Meriwether	105⅓	$ 263.34	7,600
L. J. Blakely	105⅓	263.33	7,600
Charles Sturgill	105⅓	263.33	7,600
Dr. Halbert Leet	40	100.00	17,500
L. B. Shouse	40	100.00	17,500
Gilmore N. Nunn	4	10.00	.....
Total—shareholders only	400	$1,000.00	$ 57,800
Banks	.....	.....	149,403
Total	400	$1,000.00	$207,203

The notes described above are reflected in the balance sheet attached to petitioner's return for the year ended October 31, 1946, as "Notes Payable—Bank Loans" in the amount of $149,403, and "Notes Payable—Stockholders" in the amount of $57,800.

In the *Uptegrove* case, *supra*, the taxpayer, a manufacturing corporation, reported all of its gross sales. From that figure it subtracted the "cost of goods sold" in arriving at the gross profit reported on its tax return. The Commissioner and the Courts agreed that the taxpayer overstated the cost items resulting in an understatement of its gross profit by more than 25% of the gross profit reported on its tax return. In reversing the Tax Court, the Court of Appeals for the Third Circuit meticulously traced the legislative history of Section 275(c) of the Internal Revenue Code of 1939 and concluded that it did not apply. The deficiency determinations made by the Commissioner were held to be barred by the expiration of the general three-year period of limitations. In arriving at its conclusion, the Appeals Court stated as follows:

> ". . . we think it was the manifest purpose of Congress to make an exception to the three year statute of limitation which would apply only to situations where the taxpayer had failed to make a return of some taxable gain".

Thus, the Court of Appeals for the Third Circuit stated, in effect, that Section 275 (c) means what it says; that the extended five year statute of limitations does not apply unless the taxpayer "omits" items of income. In the instant case, as in the *Uptegrove* case, no items of income were "omitted"—the petitioner merely overstated the cost basis of the property sold during the years in question.

None of the notes held by the stockholders has been paid by the petitioner with the exception of the note in the face amount of $17,500 issued to L. B. Shouse. At the time this note was paid, petitioner also purchased Shouse's 40 shares of stock at a price of $2.50 per share, or a total of $100. Sometimes after the taxable year, in 1953, Sturgill and the Central Rock Company, a corporation, acquired the stock and notes of petitioner held by the remaining stockholders, namely, Meriwether, Blakely, Dr. Leet, and Nunn. Sturgill and the Central Rock Company now own, equally, all of petitioner's outstanding stock, and the notes in the face amount of $40,300 which remain outstanding.

In the taxable years ended October 31, 1946, and October 31, 1947, the petitioner did not pay to the holders, or accrue on its books, or claim deductions on its returns for, any amounts payable as interest on the notes held by its stockholders. In the taxable year ended October 31, 1948, the petitioner paid a total of $8,988.41 to the five stockholder-noteholders, and claimed a deduction in that amount in its return for interest paid. The total amount of $8,988.41 purportedly was distributed in payment of the interest due on the notes for the 3 years ended October 31, 1946, 1947, and 1948, as follows:

Name	Payments for years ended October 31			Total paid
	1946	1947	1948	
Leet	$ 525.00	[1]$1,081.50	[1]$1,114.90	$2,721.40
Shouse	525.00	[1]1,081.50	[1]1,114.90	2,721.40
Blakely	228.00	[1]469.68	[1]484.19	1,181.87
Meriwether	228.00	[1]469.68	[1]484.19	1,181.87
Sturgill	228.00	[1]469.68	[1]484.19	1,181.87
Totals	$1,734.00	$3,572.04	$3,682.37	$8,988.41

[1]Six per cent interest on $17,500, the face amount of the notes held by Leet and Shouse, is $1,050 per year. Six per cent interest on $7,600, the face amount of the notes held by Blakely, Meriwether, and Sturgill, is $456.00. The difference between these amounts and the somewhat larger amounts actually paid, as set forth above, is not explained in the record.

In *Deakman-Wells Co. Inc., supra,* the Court of Appeals for the Third Circuit reaffirmed its decision in *Uptegrove,* stating, in part, as follows:

> "We recently had occasion to consider the scope of that subsection in Uptegrove Lumber Co. v. Commissioner of Internal Revenue, 3 Cir., 1953, 204 F. 2d 570. In that case we pointed out that the statute applies only where the taxpayer has failed to make a return of some taxable gain, where he has altogether omitted an item from the income reported, and not to a case such as this where he merely understates the final figure in his gross income computation, the item in question having been disclosed in the return but eliminated in the computation of the final figure. We adhere to the views which we expressed in the Uptegrove case and conclude that the Tax Court erred in holding section 275(c) applicable".

The Eighth Circuit was confronted with indistinguishable facts from those present in the above cited cases in *Goodenow, supra.* In rendering its decision, the Court stated, in part, as follows:

> "This Court has repeatedly ruled, particularly in tax cases, where uniformity of decision among the Circuits is vitally important, that the decision of a Court of Appeals of another Circuit should be followed unless demonstrably erroneous or unsound. See Birmingham v. Geer, 8 Cir., 185 F. 2d 82, 85 and cases cited, certiorari denied 340 U. S. 951, 71 S. Ct. 571, 95 L. Ed. 686; Commissioner of Internal Revenue v. Moran, 8 Cir., 236 F. 2d 595, 596.

In each of the taxable years ended October 31, 1949, and October 31, 1950, the petitioner paid $3,468 to the five stockholder-noteholders, and claimed deductions in that amount in its returns for each of the years for interest paid.

The respondent disallowed the entire amount claimed by petitioner as interest deductions in its returns for the taxable years ended October 31, 1948, 1949, and 1950. The deficiency notice contains the following explanation for the disallowance of the interest deduction claimed in petitioner's return for the year ended October 31, 1948:

It is held that the amount of $8,988.41 deducted as interest in the return filed for the fiscal year ended October 31, 1948, constitutes dividends within the purview of Section 115 of the Internal Revenue Code, and is therefore not allowable as a deduction in computing net taxable income.

Similar explanations are given for the disallowance of the interest deductions claimed in the returns for the years ended October 31, 1949, and October 31, 1950.

Except for items representing the notes payable to stockholders and to banks, and reserve accounts for depreciation and for improvements, the following are the only liabilities set forth in the balance sheets attached to petitioner's returns for the years ended October 31, 1946, to October 31, 1950, inclusive:

	Year ended October 31				
	1946	1947	1948	1949	1950
ccounts payable	$ 165.65	.....	.....	.....	.....
ccrued taxes	5,160.09	$1,000.43	$4,033.84	$986.94	$1,004.48
Total	$5,325.74	$1,000.43	$4,033.84	$986.94	$1,004.48

> "The decision of the Court of Appeals for the Third Circuit in the Uptegrove Lumber Co. case we regard as sound and logical. There is, we think, no reason why it should be rejected by this Court."

In *Slaff, supra,* the taxpayer received income for services performed while overseas. In his tax return, under the heading "Income", he noted the receipt of income and then stated that such income was exempt from taxation. The Court of Appeals for the Ninth Circuit held that there were no "omissions", and that it was in full accord with the interpretation of Section 275 (c) adopted by the Court of Appeals for the Third Circuit in *Uptegrove* and *Deakman-Wells.* Accordingly, it held the extended period of limitations provided for by 275 (c) inapplicable.

In *Davis* v. *Hightower, supra,* the taxpayer, on "Schedule D—Gains and Losses from Sales or Exchanges, Capital Assets, etc." reported the full amount of claimed capital gains. Fifty percent (50%) of said gains were carried forward to the face of the tax return form (Form 1040). In holding that Section 275 (c) was inapplicable, the Court of Appeals for the Fifth Circuit stated, in part, as follows:

> "The two cases decided by the Court of Appeals for the Third Circuit recognize that either construction could be placed on this statute, and largely on the basis of the legislative history, it makes the test the question whether a specific item of income has been completely omitted from the return. To this legislative history is now added

The $57,800 paid to petitioner by the five shareholders in 1946 in return for petitioner's promissory notes constituted contributions to petitioner's capital rather than bona fide loans. The payments in the fiscal years ended October 31, 1948, 1949, and 1950, to the five stockholder-noteholders in the amounts of $8,988.41, $3,468, and $3,468, respectively, did not represent payments of interest.

Issue 2. Cost of Subdivision Lots to Petitioner.

Shortly after its organization, petitioner acquired a farm near Iexington, Kentucky. The farm was approximately 228 acres in size, and was acquired by petitioner for the purpose of subdivision into residential lots. The petitioner's plan of operation was to sell lots to individual buyers, rather than to construct and sell homes. The petitioner sold lots in each of the years ended October 31, 1946, 1947, and 1950.

For the purposes of reporting gain from the sale of lots, petitioner included as part of its cost or other basis in the lots a proportionate part of the estimated cost of developing the subdivision. The amount of estimated development expenses added by petitioner to its cost of the lots was $93,074.61, and the total basis claimed by petitioner in the subdivision amounted to $131,550. As is more fully set forth hereinafter, the respondent determined that the amount of development costs which were includible in the computation of petitioner's cost or other basis in the lots did not exceed $44,988.55, and that petitioner's total basis in the subdivision did not exceed $83,463.94. The amount of development expenses claimed by petitioner which was disallowed by respondent, $48,086.06, represents the following three items: The portion of the original estimated cost of development, $93,074.61, which petitioner had not expended as of September 30, 1950; the expenditures made by petitioner to acquire a water supply system;

> the amendment contained in the 1954 Internal Revenue Code, under the terms of which it is now clear that the inclusion of the statement made by appellee in his return here would be sufficient to prevent application of the five year statute. In view of the confusion as to the meaning of the statute prior to the adoption of the 1954 Code, we think it plain that the new language was enacted to clarify the existing law. On logic as well as precedent, therefore, we find that the full and complete statement by the taxpayer of every gross item of income and gain received by him as required by the return itself, rebuts the contention of the Commissioner that the five year statute applies to this case."
>
> (Footnotes 6 and 7 omitted.)

As indicated in the above excerpt from *Davis* v. *Hightower*, Congress, in enacting the Internal Revenue Code of 1954, adopted the interpretation of Section 275.(c) of the 1939 Code enunciated by all Courts of Appeal which had passed upon the question, exclusive of the Court of Appeals for the Sixth Circuit. See Section 6501 (e) of the Internal Revenue Code of 1954 (App. 13). However, Section 6501 (e) of the 1954 Code is not applicable for tax years ending prior to January 1, 1954. See Section 7851 (d) of the Internal Revenue Code of 1954 (App. 14).

The federal income tax touches the lives of nearly all of the citizens of the United States. It must be uniformily administered.

The decision of the Court in the case below stands alone among the decisions of the Courts of the various

and the amount of payments made by petitioner to two utility companies. The amount of each of the three items is as follows:

Unexpended part of estimated development costs	$ 5,590.82
Expenditures for water supply system	33,781.70
Payments to utility companies	8,713.54
Total	$48,086.06

The first part of petitioner's real estate to be subdivided was The Colony, which comprised about 65 lots covering approximately 60 acres. When subdivision of The Colony began, there was no available source of water. Without water, the lots would not have been salable. The petitioner was advised that it would cost between $40,000 to $60,000, and perhaps more, to connect The Colony with the facilities of the Lexington Water Company, which were approximately 1½ miles away. The petitioner's stockholders decided that petitioner would construct a water system to provide water to lot purchasers instead of entering into any arrangement with the Lexington Water Company. Prior to 1949, the petitioner completed a water supply and distribution system for The Colony. The chief source of water for the system is a well capable of producing 576,000 gallons of water each 24 hours. Water from the well is pumped automatically by turbine pump through a chlorination tank to a 55,000-gallon capacity concrete pool, and then, by highlift pumps, into a 3,000-gallon capacity steel pneumatic tank. For convenience, the portion of the water system described above is referred to as the pumping system. From the pneumatic tank, the water passes into the "distribution system," which consists of 6,500 feet of 4- and 6-inch pipe, about 2,500 feet of 2-inch pipe, and meters to the various houses.

Circuits. Unless this Court assumes jurisdiction and settles the principle of law involved in this case, petitioner, and the citizens of the States of Ohio, Michigan, Tennessee, and Kentucky, will be treated differently from the citizens of the various other States.

CONCLUSION.

The decision below presents the strongest possible reasons for review by this Court.

It is in direct and irreconcilable conflict with the decisions of the Courts of Appeal for the Third Circuit, Eighth Circuit, Ninth Circuit, and Fifth Circuit.

We respectfully submit that we can not have one law for taxpayers in the Sixth Circuit and an opposite law for all other taxpayers.

For the foregoing reasons this petition for certiorari should be granted.

Respectfully submitted,

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